CIA paper

IS THERE "ADDED COMPENSATION" IN A HOUSING ALLOWANCE? HOW MUCH?

1. During the past few weeks we have frequently discussed the sections of the Comptroller General's report which pertain to elements of "added compensation" in allowances paid to U.S. Government employees overseas, and particularly the quarters allowance. The report seems to assume that the added compensation is equal to the amount an employee would be paying for living quarters if he were working in Washington and thus not entitled to an allowance. It was suggested that certain official indices, such as the housing statistics of the Bureau of Labor Statistics, could be used to quantify this "added compensation" and establish it as a specific sum of money for families of various sizes at various income levels. Earlier studies which have been conducted have concluded that, while there may be an element of net profit in a quarters allowance, it is not possible to verify that it exists or demonstrate how much it is. We believe that, if there is to be a meaningful evaluation of this added compensation, it is not only necessary to determine approximately how much it is, but, having arrived at that approximate value, determine whether it is significant enough to be regarded as a problem which requires Congressional action and a reversal of policies which have now been in effect for more than three decades. We believe that the existence of added compensation is debatable, it would not be possible to develop a

methodology to fairly quantify the compensation value over the broad range of affected employees, that other related costs and disadvantages which confront employees overseas more than offset whatever profit may be realized from the quarters allowance, and that, if added compensation is present, it is so modest that it does not warrant a drastic revision of the most fundamental of all of the overseas entitlements.

2. When an individual is permanently assigned to Washington or some other city, he views his requirement for housing as a long-term program which is about one-half housing and one-half investment. The employee assigned overseas, however, is compelled to view his housing requirements as an immediate problem susceptible of only short-term solutions. His allowance may cover his housing costs but generally it will not, and in any case he concludes his tour having spent his allowance on the expense it was intended to cover. He has nothing left over as a "profit" or an investment. One cannot simply assume that an employee overseas can regularly invest an amount equivalent to his stateside rent, so that at the conclusion of his tour he will have realized benefits equal to the amount which he would have spent on housing had he been in Washington. The economic facts of life make that impossible.

3. The discussion of the costs involved can be approached several ways. First, assume a senior officer at the GS-15 or FSO-2 level, whose salary is between $30,000 and $36,000 per year. The general rule of

thumb for lending organizations is that an individual at this salary level could carry a mortgage with monthly payments approximately equal to one week's salary. On this basis, the individual could carry a mortgage in excess of $70,000, and he might search for a home above that range. For discussion purposes, assume that the individual has bought a home worth $70,000, has made a down payment of $10,000, and has mortgage(s) of $60,000, at 9% interest, with a maturity date of 25 years. The monthly payments on this mortgage would be $503.32. Exclusive of the down payment, at the end of the 25 year term the employee would have expended $150,996.00 (300 x $503.32). This means that he would have repaid $60,000 in principal and paid $90,996 in interest. If we assume that he paid $1,000 per year in taxes, and that his house has retained its market value of $70,000, his net cost for the 25 years would be approximately $116,000 (interest on the loan plus taxes). Over the 25 years this would average about $4,600 per year before income taxes. The individual would receive Federal and State income tax benefits for both the real estate taxes and interest, which would be a minimum of 30% of the total and probably more. The cost of $4,600 per year would thus be reduced to about $3,200 per year. If we add $800 per year for utilities, we have a total cost (less investment) of about $4,000 per year.

4. There are many relatively junior employees overseas with dependents and it is possible to construct similar examples for the lower grades. If an

individual buys a home at a lower price and assumes mortgage(s) totaling $25,000 at 9% for 25 years, his monthly payment would be $209.80. In 25 years (300 payments) he would have paid $62,940, which includes the repayment of the $25,000 loan and $37,940 in interest. If we assume real estate taxes of $500 per year, his total cost for the 25 years would be $50,440, or approximately $2,000 per year. Assuming that this employee is paying State and Federal income taxes at a combined rate of only 20%, the annual cost is reduced to $1,600 per year. Approximately $500 per year for utilities would result in a net cost of about $2,100. We could thus assume that the net cost to a homeowner would be between $2,000 and $4,000 per year with the actual cost depending on the employee's income, the size of his family, the amount of his initial investment as a down payment, and his personal preferences.

5. The next consideration is the substantial appreciation in the value of real estate in the Washington area over the past few years. This is admittedly a factor which would be difficult to incorporate into a housing policy, but it is nevertheless a fact of life which results in substantial benefit for employees who own their homes. It is a demonstrable fact that real estate values in Washington have not diminished during the past thirty years, and employees permanently assigned to Washington have an opportunity to take advantage of that trend. Those assigned overseas generally do not. Employees who have purchased homes in this area have found that

they can almost always be sold for more than the original cost. Increases of as much as 50% in a period of three or four years are not uncommon, and comparable increases over a period of ten years are becoming normal. Thus, the average cost of $2,000 to $4,000 per year, computed in paragraphs 3 and 4, is reduced to a range of $1,300 to $2,700 if the appreciation in value is amortized over the period during which the property is owned. There are many cases where owners selling real estate have recovered the entire cost of owning and maintaining the home, and it is difficult to find anyone who has lost money in a real estate transaction in recent years. We believe that this is a very pertinent consideration in any effort to determine whether employees overseas are receiving unwarranted benefits simply because they are being provided housing. The employee overseas does not have an opportunity to plan a housing program which is also a major investment.

6. The conclusions in preceding paragraphs must, of course, be qualified. They are reasonably accurate for employees living in government owned or leased property, since in those cases the government handles most of the maintenance and repair as well as the rent, and the employee pays only for such things as lawn care. When employees are paid an allowance, however, the conclusions in paragraphs 3, 4 and 5 will not always apply. An allowance rarely covers all of the cost of quarters, and in more than half of all cases the employee finds that he must pay a part of the cost himself. In many cases the amount paid by the employee would be more than the "added compensation" factor computed in paragraph 5 above. The employee's

out-of-pocket contribution may sometimes be based on his personal preferences concerning location or type of accommodations but it is usually due to inflation and scarcity of housing. For the past three years the dramatic increase in inflation, accompanied by the general reduction in the value of the U.S. dollar abroad, has caused the price of housing to increase so fast that the system of review cannot keep pace. It normally takes at least two to three months to effect a change in the housing allowances, even under the best of circumstances, and during this period the employee must pay the increased costs himself. In one sampling of a selected portion of the overseas population it was determined that about 80% of all employees drawing an allowance were having to pay for part of the costs themselves, and that the range was from a few dollars to as much as several thousand dollars a year. Most of the single or junior employees were able to keep the excess to about $300 to $500 per year, but the senior employees were generally spending much more of their own funds. In many areas the rents have remained reasonably stable but the cost of utilities, and especially electricity and heating oil, have escalated to an unbelievable degree. When fuel costs suddenly skyrocketed in many sections of South America in 1974, large numbers of employees suddenly found themselves out-of-pocket by as much as $1,000 in three months. For these reasons we feel that the final estimates in paragraph 5 would have to be reduced by at least half when the employees are drawing an allowance and are personally responsible for the costs which exceed the allowance. This means that in Africa, in denied areas of Eastern Europe, in most of the Middle East, and parts of Asia, the computed factor might be applied. These, however, are the areas where we have the fewest employees per post and where the general hardships are such that one could not possibly conclude that a modest housing benefit is an unwarranted windfall. In Western Europe, Latin America and the more modern cities of the Middle East and Asia, we have the largest posts with the greatest number of employees, and it is here that we find employees drawing the allowance and paying part of the cost themselves.

7. Another consideration which tends to diminish "added compensation" is the hidden cost associated with changing one's residence every two or three years. Most employees now estimate this to be about $500 per move. General weight limitations make it impractical to simply ship entire households from one place to another, and employees always find that, when they move, it is necessary to dispose of some property which still has value and will have to be replaced at the next location. Heavy appliances are usually sold at a loss, particularly if they are four or five years old and of doubtful reliability because of inadequate local maintenance. The alternative would be to gamble on a bill for an overweight shipment. Items such as brooms,

trash cans, opened boxes of detergents and soap, food, beverages, and numerous household aids are simply left behind or given away. In addition, the forced sale of an automobile generally results in a significant loss. These costs are, of course, in addition to the trauma associated with the move itself, and losses and damage which occur to valued possessions but which would be more properly discussed by the Working Group on the shipment of household effects. It is clear, however, that moving every two or three years results in losses which will vary from one family to another and which cannot be anticipated or stated as a specific sum of money.

8. The discussion above concerns what we regard as the average situation, and there are, of course, exceptions to the norm. Some employees prefer apartment life to home ownership, and live in apartments wherever they are. In such circumstances it might be concluded that there is added compensation. There are so few employees in this category, however, that they should not influence overall policy. There are also some employees who own their own homes in the United States and retain them during the overseas tours. Again, however, they are the exception rather than the rule. It is obvious that no employee could afford to own a home and leave it vacant during an overseas assignment. Economic considerations will compel him to rent it while he is away, and the major objective will be to have the rent cover the mortgage payments. We have not attempted to obtain specific cost data,

but we feel confident that the temporary benefits received from the combination of rent and allowance would not differ greatly from the figures computed in paragraphs 3 and 4. Experience has shown that, with the high interest rates now being charged, rental payments do not always cover the mortgage payments, and, in spite of income tax deductions, certainly would not cover all the other related expenses. There are invariably repairs which have to be made when the house is reoccupied, appliances and lawnmowers have to be replaced, damage to carpets and gardens must be restored, and personal belongings which have been lost or stolen must be replaced. For these reasons we feel that the two situations described in this paragraph are not really a major consideration.

9. In trying to decide whether an allowance benefits an employee to an unwarranted degree, perhaps the best question to ask is, "Where does he stand when it is all over?" At the time of retirement an employee who has spent his career in Washington or some other city has a substantial investment in his home, and it may in fact represent the bulk of his estate. The overseas employee who is provided quarters or given a quarters allowance has no residual value at all at the conclusion of a tour or a career. Consequently, the retiring headquarters employee has a substantial advantage over the employee who has spent his career abroad and has not been able to develop a housing program which would also provide for his housing

after retirement. It is too simplistic to say that the overseas employee should have put aside the $2,000 to $4,000 per year to provide a cash reserve in lieu of the home. Allowances come in neat packages but salaries do not. Overseas employees are caught in the inflation both at home and abroad, and constantly increasing costs have made savings just as difficult for the employees overseas as it is for those at headquarters. The net result is that whatever "compensation" there is must be diverted to the essential living expenses, and it is simply not possible for the average employee to put aside significant amounts of money on a regular basis. An employee at headquarters has considerable latitude in "cutting corners," deferring certain expenses, or making other arrangements when necessary. The employee overseas lives under more rigid rules, and when he is confronted with personal expenses the obligations must be met promptly from available resources. Experience has shown that it is not reasonable to assume that employees overseas could save up to $4,000 per year.

10. Employees are genuinely concerned that there are elements of the administration who feel it appropriate to reduce vital benefits at a time when the cost of living overseas is the highest in history. When an employee is going overseas, the availability of quarters is the most important personal consideration to him and his family. They are moving to a strange country and a different culture, and if the employee can speak the language the

family usually cannot. The suitability of the living accommodations will become the single most important consideration to the family, and the family's adaptability to the area will have a significant bearing on the employee's performance of his official duties. The employee is aware that the assignment of quarters or the payment of an allowance represents a benefit which he would not have if he were assigned to Washington. To the employee, however, this does not represent a dollars and cents benefit which will result in an increase in his bank account. Rather, he views it as an assurance from his employer that, in taking his family to a foreign country, he will not suddenly be impoverished by being thrown into an inflated housing market which is totally beyond his control. As the number of overseas positions are reduced, it becomes even more essential that those positions be staffed with the most competent employees available, and that in turn means that the best must be willing to go. We cannot program overseas assignments on a volunteer basis, with employees selecting the posts they prefer and refusing those where the safety and comfort of their families may be subject to economic restrictions. It is imperative that the assignments be programmed in advance, and that employees consider nomination on the basis of professional rather than personal considerations. This would not be possible if each employee had to accept or reject posts on the basis of the availability of quarters. We must be able to assure employees that, wherever they go, the housing policies will be as uniform as possible.

11. The question then, is whether the "added compensation" to the employee represents an unjustified source of revenue to him, and whether the best interests of the government require that the allowance now be legislatively withdrawn or reduced in spite of the fact that it has been a part of basic pattern of allowances for thirty years, and notwithstanding the certain adverse impact on the morale of thousands of employees overseas. It is our view that the disadvantages would greatly outweigh any benefits which might be realized. We feel that either of the major changes being considered (assessing the employee for a part of the cost or declaring it taxable) would result in a net loss both to the government and to the employee. If the cost of operating overseas must be lowered, there are other means of accomplishing it which are more acceptable than passing the increased costs along to the employee.